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EXECUTIVE SECRETARIAT

ROUTING SLIP

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Remarks

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Executive Secretary

10 Aug 85

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Executive Registry
85- 3019/1
1 Aug 85

MINUTES
ECONOMIC POLICY COUNCIL

August 1, 1985
11:00 a.m.
Cabinet Room

Attendees: The President, The Vice President, Messrs. Baker, Weinberger, Block, Baldrige, Regan, Yeutter, Sprinkel, Whitehead, Ford, Wright, Kingon, McAllister, Buchanan, Friedersdorf, Oglesby, Speakes, Thompson, Naylor, Chew, Dawson, Hobbs, Khedouri and Niehenke, and Ms. Dole.

1. The Farm Bill

Secretary Block stated that the economic conditions under which the farm bill is being drafted are dismal: exports are down 25 percent; interest rates for many farmers are increasing; farm prices are low; one-half of farmers are losing money; and one-third are sliding toward insolvency. He explained that Congress's primary intention in drafting the farm bill is to maintain farm income. However, to expand farm exports, another important objective, prices must come down. The only way to meet the two objectives is to significantly increase Federal spending on agricultural programs.

Assistant Secretary Thompson traced the origins of the current agricultural problems to the 1970s. During the 70s farming prospered because markets abroad were growing. Rising farm prices and the expectation of continued general inflation prompted increased investment in machinery and equipment and real estate. The changing macroeconomic conditions of the 1980s -- the rising value of the dollar, rising interest rates, and declining inflation -- have dampened the demand for U.S. agricultural products abroad and increased the cost of land and capital. As a result of the resulting squeeze on earnings, 53 percent of farms in 1984 had negative cash flow. Farmers in the Corn Belt, Lake States and Northern Plains, in particular, are facing severe cash flow difficulties.

Secretary Block illustrated the expansion in the farm bill by pointing out that the Administration's farm bill proposed spending of $22 billion, the Senate Budget Resolution provided for $32 billion, and the Senate and House agriculture committees are working on bills that would cost over $50 billion. He stated that the Economic Policy Council has identified several unacceptable provisions for a farm bill, including mandatory supply control, marketing loans, a dairy diversion program, a simple extension of current law, and the establishment of price or income supports.

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Secretary Block stated that the Administration should seek to reduce income supports, delete authority for market loans, delete the dairy diversion provision, and reduce dairy supports. He asked the President for a meeting of the Legislative Strategy Group to develop an approach to highlighting the Administration's opposition to the costly elements of the farm bills being drafted and developing a strategic approach for dealing with Congress.

The Council also discussed with the President a number of conceptual approaches to reducing the Federal Government's influence on agricultural economic decisions.

2. Agricultural Credit Policy

Undersecretary Naylor reported that the agricultural credit situation mirrors the farm income situation. He explained that the Federal Government has a large stake in the deteriorating credit situation through the exposure of the Farmers Home Administration (FmHA), a government agency, and the Farm Credit System (FCS), a privately owned, but Federally sponsored farm lender. The FmHA is becoming a lender of last resort, as commercial banks and the FCS are turning away borrowers, who are then turning to the FmHA for operating loans, which enable the borrower to use his other resources to meet real estate debt expenses. These loans are becoming "entitlements" as several court rulings have inhibited the FmHA's ability to foreclose on delinquent loans. He estimated that $8.5 billion, one-third of FmHA portfolio, is uncollectable.

Mr. Naylor reported that although the FCS is in good overall fiscal condition there are district banks that are in trouble, the most serious of which is the Omaha district bank. The FCS has two impediments to addressing its regional problems: (1) the system is highly decentralized and operates on a consensus basis. Because the FCS's equity is spread among 900 separate entities, and these entities are required to share losses only if there is a technical default, districts cannot easily draw on the resources of other districts; and (2) the Farm Credit Administration (FCA), which supervises the FCS, lacks the regulatory and enforcement powers to require acceptable credit standards.

Mr. Naylor outlined the four options developed by the Economic Policy Council:

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1. Limit FmHA direct lending to servicing its existing portfolio. Eliminate FmHA real estate lending. Limit FmHA to guaranteeing new operating loans up to a maximum of 70 percent.

   Encourage the FCS to solve its problems without Federal aid or interference.

2. Limit FmHA direct lending to servicing its existing portfolio. Limit FmHA real estate lending to current levels. Continue FmHA guaranteeing new operating loans up to a maximum of 90 percent.

   Encourage the FCS to solve its problems without Federal aid or interference.

3. Limit FmHA direct lending to servicing its existing portfolio. Eliminate FmHA real estate lending. Limit FmHA guaranteeing new operating loans up to a maximum of 70 percent.

   Require the FCS to utilize its internal resources, restructure the FCA to provide it strong regulatory and enforcement powers and establish an insured fund. In exchange, the Federal Government would provide a line of credit or direct Federal financing for the FCS.

4. Limit FmHA direct lending to servicing its existing portfolio. Eliminate FmHA real estate lending. Limit FmHA guaranteeing new operating loans up to a maximum of 70 percent.

   Require the FCS to utilize its internal resources and restructure the FCA to provide it strong regulatory and enforcement powers and establish an insured fund. In exchange, the Federal Government would consider creating a Federally-chartered, privately-owned credit institution (Aggie Mae) to purchase nonperforming loans.

Mr. Naylor stated that the Economic Policy Council unanimously recommends option 2, which can be implemented with existing authorities.

Secretary Baker stressed that the Administration should emphasize that the FCS is in good fiscal health and that we are confident that it has the resources to address its own problems, now and in the future.

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Decision

The President accepted the Economic Policy Council's recommendation and adopted option 2.

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